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TAX FOUNDATION'S VOL. 30, NO. 4 APRIL 1986

# TAX·FEATURES

# Tax Freedom Day is May 1

## Tax Bite From 8-Hour Pay Of Average U.S. Worker Is 2 Hours, 39 Minutes

The bad news is that taxes will take a 2-hour, 39-minute bite from the average worker's 8-hour earnings in 1986. The good news is that's the same size bite taxes took last year, according to economists at the Tax Foundation.

Federal taxes will claim, as they did in 1985, one hour and 44 minutes of a worker's earnings, while state-local taxes preempt 55 minutes' worth of productive labor. The total tax bite from the workday is far ahead of the next most costly item, housing and household operation, which will require a worker to put in 1 hour and 26 minutes on the job, a minute less than in 1985. Third come food and tobacco, which will consume an hour's worth of work, the same time span as last year, according to Foundation analysis.

Researchers at the Washington-based tax watchdog organization detect only minor shifts in the allocation of a day's pay over the last 12 months. Earning the money for the clothing budget will require 18 minutes on the job, 1 minute less than 1985, as will covering medical expenses (37 minutes in 1986 vs. 38 minutes in 1985).

The largest growth was in the area of miscellaneous costs, a catch-all category comprising personal care, personal business, private education, religious

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**Tax Freedom Day**

**Selected Years 1930-1986**

| Year | Tax Freedom Day |
|---|---|
| 1930 | February 13 |
| 1940 | March 8 |
| 1950 | April 3 |
| 1960 | April 17 |
| 1970 | April 28 |
| 1975 | April 28 |
| 1980[a] | May 1 |
| 1981[a] | May 4 |
| 1982[a] | May 3 |
| 1983[a] | April 30 |
| 1984[a] | April 28 |
| 1985[a] | May 1 |
| 1986[b] | May 1 |

[a] Revised. [b] Forecast.

May 1 is Tax Freedom Day 1986. This means it takes from January 1 through April 30 to earn the money to pay the average American's tax bill, assuming every dollar in the paycheck is allocated for Federal, state and local government taxes.

Economists at the Tax Foundation annually calculate Tax Freedom Day as a way of showing the size and weight of government on the economy. Since 1984, the date has moved three days later in the calendar—from April 28 to May 1. (Revisions based on updated government data show that Tax Freedom Day, 1985, also fell on May 1, a day later than originally estimated.)

Is the taxpayer losing ground, since the day when the burden of taxation symbolically lifted from his shoulders is once again slipping further into the year? To some extent, yes, according to Tax Foundation analysts.

When the passage of the Economic Recovery Tax Act of 1981 (ERTA) stopped the on-going rise of Federal taxes, Uncle Sam's tax take dropped slightly relative to income (time worked) until 1985, when it rose again. Taxes are estimated at about the same ratio to working time in 1986 as in 1985, but still that is below 1981.

(ERTA cuts were, of course, diminished by subsequent Congressional take-backs of business tax cuts in 1982 and 1984, higher excise taxes on gasoline and cigarettes, and hikes in payroll taxes instituted to restore the troubled social security system to solvency.)

However, all that was gained under ERTA has not yet been lost. Before that landmark tax reduction measure, Tax Freedom Day fell on May 4 (1981), and the American worker had to put in 124 days on the job to cover tax liabilities. Today, 121 days in harness covers a worker's taxes.

On the other hand, state-local taxes have generally risen faster than incomes over the past six years, taking up any potential "leisure time" that taxpayers may otherwise have enjoyed from Federal cuts. The net result appears to be that we are back where we started in 1980—a May 1 date for Tax Freedom Day.

To some extent, the average taxpayer is also a victim of the economy's successful recovery. Tax collections have risen along with the rising economy and growing incomes of Americans, Foundation researchers point out, causing the flow of revenues to Federal, state and local treasuries to increase as well.

The May 1 date for Tax Freedom Day marks the third time in the 1980s that this landmark day for the tax-

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# '86 Federal Tax Burden Tops $752 Billion; CA, NY, and TX Lead the 50 States

For all the talk of austerity in Washington, Uncle Sam's take from the taxpayer continues to grow ever larger. Federal taxes will hit $752.2 billion in the current fiscal year (1986), according to economists at the Tax Foundation. The Administration's 1987 budget as presented on February 5 projects an increase of $42.8 billion (6.0 percent) over the $709.4 billion collected in taxes in 1985. The overall rise mirrors annual increases of $19 billion in individual income taxes, nearly $10 billion in corporate income taxes, and over $17 billion in social security levies, offset somewhat by projected reductions in miscellaneous taxes.

Federal tax revenues for fiscal 1987 are projected to climb by another $70.2 billion (9.3 percent) over 1986 levels. Again in 1987, individual income taxes will be the biggest factor in the rise, going up another $32 billion, followed by a $21 billion hike in social security taxes and $16 billion in corporate tax bills. This tax burden falls unevenly among the states as the following breakdown shows.

**Estimated Total and Per Capita Federal Tax Burdens by State**
**Fiscal Years 1985-1987**

| State | Total burden (millions) | | | Per capita burden | | | State rank 1986 | |
|---|---|---|---|---|---|---|---|---|
| | 1985 | 1986 | 1987 | 1985 | 1986 | 1987 | Total | Per Capita |
| TOTAL | $709,400 | $752,178 | $822,386 | $2,982 | $3,133 | $3,395 | — | — |
| Alabama | 8,996 | 9,526 | 10,400 | 2,234 | 2,344 | 2,536 | 24 | 45 |
| Alaska | 2,355 | 2,489 | 2,711 | 4,676 | 4,907 | 5,306 | 44 | 1 |
| Arizona | 8,271 | 8,789 | 9,631 | 2,590 | 2,632 | 2,758 | 27 | 35 |
| Arkansas | 5,011 | 5,308 | 5,800 | 2,148 | 2,230 | 2,388 | 32 | 48 |
| California | 86,183 | 91,441 | 100,028 | 3,324 | 3,485 | 3,767 | 1 | 9 |
| Colorado | 10,178 | 10,799 | 11,815 | 3,115 | 3,214 | 3,420 | 23 | 14 |
| Connecticut | 13,282 | 14,097 | 15,429 | 4,215 | 4,478 | 4,906 | 17 | 3 |
| Delaware | 1,994 | 2,113 | 2,309 | 3,239 | 3,416 | 3,715 | 47 | 10 |
| Florida | 33,177 | 35,271 | 38,696 | 2,927 | 3,013 | 3,201 | 6 | 23 |
| Georgia | 15,395 | 16,343 | 17,884 | 2,613 | 2,748 | 2,979 | 12 | 34 |
| Hawaii | 2,974 | 3,158 | 3,457 | 2,819 | 2,949 | 3,179 | 40 | 25 |
| Idaho | 2,179 | 2,308 | 2,522 | 2,108 | 2,162 | 2,288 | 45 | 50 |
| Illinois | 38,475 | 40,746 | 44,494 | 3,343 | 3,541 | 3,867 | 4 | 8 |
| Indiana | 14,915 | 15,822 | 17,309 | 2,698 | 2,847 | 3,098 | 15 | 32 |
| Iowa | 8,078 | 8,566 | 9,372 | 2,765 | 2,919 | 3,181 | 28 | 27 |
| Kansas | 7,480 | 7,936 | 8,686 | 3,063 | 3,244 | 3,545 | 29 | 13 |
| Kentucky | 8,502 | 9,004 | 9,834 | 2,250 | 2,347 | 2,525 | 26 | 44 |
| Louisiana | 11,522 | 12,199 | 13,320 | 2,685 | 2,786 | 2,981 | 22 | 33 |
| Maine | 2,752 | 2,916 | 3,186 | 2,356 | 2,471 | 2,673 | 42 | 43 |
| Maryland | 15,193 | 16,119 | 17,626 | 3,475 | 3,667 | 3,988 | 14 | 6 |
| Massachusetts | 20,451 | 21,690 | 23,717 | 3,537 | 3,761 | 4,124 | 10 | 5 |
| Michigan | 26,213 | 27,728 | 30,239 | 2,872 | 3,020 | 3,275 | 9 | 21 |
| Minnesota | 12,487 | 13,249 | 14,493 | 2,977 | 3,135 | 3,403 | 20 | 17 |
| Mississippi | 4,948 | 5,243 | 5,730 | 1,885 | 1,978 | 2,139 | 33 | 51 |
| Missouri | 14,124 | 14,988 | 16,409 | 2,814 | 2,979 | 3,254 | 16 | 24 |
| Montana | 2,046 | 2,171 | 2,376 | 2,452 | 2,570 | 2,777 | 46 | 38 |
| Nebraska | 4,433 | 4,711 | 5,166 | 2,751 | 2,913 | 3,183 | 34 | 28 |
| Nevada | 3,005 | 3,180 | 3,470 | 3,119 | 3,121 | 3,219 | 39 | 18 |
| New Hampshire | 3,142 | 3,338 | 3,656 | 3,135 | 3,247 | 3,465 | 38 | 12 |
| New Jersey | 29,802 | 31,583 | 34,504 | 3,966 | 4,203 | 4,592 | 8 | 4 |
| New Mexico | 3,409 | 3,617 | 3,960 | 2,364 | 2,477 | 2,677 | 37 | 42 |
| New York | 59,251 | 62,877 | 68,795 | 3,383 | 3,635 | 4,027 | 2 | 7 |
| North Carolina | 15,225 | 16,138 | 17,631 | 2,450 | 2,576 | 2,791 | 13 | 37 |
| North Dakota | 1,889 | 2,001 | 2,186 | 2,759 | 2,928 | 3,205 | 48 | 26 |
| Ohio | 30,657 | 32,466 | 35,457 | 2,851 | 3,019 | 3,296 | 7 | 22 |
| Oklahoma | 9,101 | 9,657 | 10,569 | 2,732 | 2,870 | 3,110 | 24 | 29 |
| Oregon | 7,047 | 7,460 | 8,157 | 2,542 | 2,598 | 2,738 | 31 | 36 |
| Pennsylvania | 34,297 | 36,283 | 39,581 | 2,889 | 3,064 | 3,351 | 5 | 20 |
| Rhode Island | 2,896 | 3,067 | 3,346 | 3,016 | 3,200 | 3,497 | 41 | 15 |
| South Carolina | 7,391 | 7,842 | 8,574 | 2,212 | 2,317 | 2,501 | 30 | 46 |
| South Dakota | 1,641 | 1,745 | 1,915 | 2,329 | 2,481 | 2,728 | 49 | 41 |
| Tennessee | 11,605 | 12,294 | 13,427 | 2,431 | 2,544 | 2,745 | 21 | 39 |
| Texas | 50,557 | 53,626 | 58,666 | 3,115 | 3,255 | 3,507 | 3 | 11 |
| Utah | 3,669 | 3,886 | 4,243 | 2,145 | 2,193 | 2,311 | 36 | 49 |
| Vermont | 1,286 | 1,363 | 1,490 | 2,394 | 2,503 | 2,699 | 51 | 40 |
| Virginia | 17,305 | 18,368 | 20,101 | 3,042 | 3,199 | 3,468 | 11 | 16 |
| Washington | 13,232 | 14,023 | 15,326 | 2,972 | 3,075 | 3,283 | 18 | 19 |
| West Virginia | 4,183 | 4,428 | 4,833 | 2,128 | 2,236 | 2,424 | 35 | 47 |
| Wisconsin | 13,153 | 13,918 | 15,185 | 2,735 | 2,868 | 3,101 | 19 | 30 |
| Wyoming | 1,537 | 1,627 | 1,776 | 2,854 | 2,865 | 2,968 | 50 | 31 |
| District of Columbia | 2,506 | 2,657 | 2,904 | 4,170 | 4,582 | 5,193 | 43 | 2 |

Source: U.S. total taxes as shown in the Federal budget submitted February 1986; computations of total and per capita tax burdens by state were made by Tax Foundation.

## Highest Burdens

As they have almost every year in recent decades, California, New York, and Texas hold the questionable honor of carrying the largest Federal tax burdens in the nation. Total dollar amounts collected in Federal taxes tend to be highest in the most populous states, explain Tax Foundation analysts.

Just ten states will send almost 58 percent of all revenue collected in Washington, even though they have less than 54 percent of the population. These "top ten" account for $433.7 billion of all Federal taxes. Ranked in descending order, they are:

| | |
|---|---|
| CA | $91.4 billion |
| NY | $62.9 billion |
| TX | $53.6 billion |
| IL | $40.7 billion |
| PA | $36.3 billion |
| FL | $35.3 billion |
| OH | $32.5 billion |
| NJ | $31.6 billion |
| MI | $27.7 billion |
| MA | $21.7 billion |

## Lowest Burdens

Sharply contrasting with this huge tax load is the burden borne by the lowest ten. With 3 percent of the population, the following states will also

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**Tax Features**

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**Tax Foundation, Incorporated**
One Thomas Circle, N.W., Suite 500
Washington, D.C. 20005
(202) 822-9050

TAX FOUNDATION, INCORPORATED
ONE THOMAS CIRCLE, N.W., SUITE 500

WASHINGTON, DC 20005
TELEPHONE (202) 822-9050

FEDERAL TAX POLICY MEMO

Editor: Edward A. Sprague, Vice President–Tax and Economic Affairs APRIL 1986

# Excises, Amnesty, and Fiscal Foibles

The Senate is being dragged reluctantly but without too much screaming and kicking to adoption of several revenue "enhancers" to flesh out the tax reform plan and/or reduce the deficit.

As for reform, the President's insistence on a 35% top rate and a full $2,000 exemption for middle-incomers set off a scramble for new money to keep the measure revenue neutral, on paper anyway. But most of what is politically acceptable in the way of base broadening is already spoken for in the House version (H.R. 3838). Some other ideas—such as amortizing part of advertising expense or disallowing part of business interest deductions—were floated and promptly sank. Thus, the Chairman of the Finance Committee, Bob Packwood, in setting up his Chairman's mark, was forced to turn *back* to limitations on state/local tax deductions and *out* to a new revenue source as the principal ways to balance the package. ***Raising the excise tax take, for the first time in the reform effort, would go outside of what could be considered "tax reform" options, and to some extent even outside of the income tax structure itself, to pick up significant new revenues.***

Actually, most of the estimated $75 billion revenue increase from excise sources over five years would come from corporate and individual income tax payments after disallowing the business deduction for Federal excise taxes and tariffs paid. Apparently, however, additional tax would be imposed whether or not the excises have been taken into income and deducted. Businesses that thought they were acting only as collection agents, such as airlines and telephone companies, also would be hit by the new impost.

There isn't any real "reform" rationale here. It's a simple money grab, as are the companion proposals to price index the alcohol, tobacco, and motor fuels excises and to raise the wine excise. The President, of course, has stated quite emphatically that the only kind of tax increase he will countenance is one that helps balance tax reform. And these excise tax proposals would seem to fit in that category.

## Deficit Euphoria

Meanwhile, back at the deficit reduction game, the Senate Budget Committee, much more willing to entertain tax increases than the President, is looking at various measures, including a Federal tax amnesty, to help meet the Gramm-Rudman-Hollings deficit targets for fiscal 1987 and afterwards. This is taking place amidst much more optimistic assumptions about the size of the deficit problem. According to both OMB and CBO estimates, Congress may need to come up with as little as $30 billion in deficit reduction actions to achieve, on paper, the fiscal 1987 Gramm-Rudman-Hollings deficit target. (That target is $144 billion, but there is a $10 billion leeway before the automatic "sequestration" process is triggered.) A more conservative defense spending outlook, falling oil prices and interest rates, and a buoyant general economy have combined to produce an almost euphoric sense of improvement in the budget outlook regardless of the fate of the Gramm-Rudman-Hollings initiative. In its first report, the Tax Foundation's *Shadow Committee on the Federal Budget* explicitly warned that this euphoria was based on changed *assumptions* rather than actual changes in budget policy and that achievement of the fiscal 1988 and later deficit reduction targets would "depend on a clock-work falling into place of optimistic economic assumptions and expenditure restraint unprecedented for more than 50 years."

Congress, however, operates mainly on a pretty short time frame—November 1986 in particular—and in dealing with the fiscal 1987 budget, the problem does look a lot more manageable than a few months ago. Concurrently, talk of a major new revenue source, such as the business transfer tax or a big-bucks energy tax, has died down. ***If more humdrum tinkering with the system—excise tax increases, Federal tax amnesty, perhaps some user fees from the President's budget proposals—can do the job, why get bogged down in major controversy over value-added or energy taxation?*** And if such tinkering could raise, say, $15 billion in new money for fiscal 1987, it could go almost halfway toward meeting the deficit target without closing the Library of Congress, shutting down the Coast Guard, and some other politically frightening things that are said to happen if the Gramm-Rudman-Hollings target must be accomplished through expenditure cuts alone. Or so the thinking goes, anyway.

## Policy Issues in Excise Taxation

It's somewhat ironic that tax reform should be trying to raise excise taxes, directly or indirectly. One may recall that a capstone of tax policy in the 1960's was to abolish a good number of the then selective Federal excises including manufacturers' excises on appliances and automobiles, retail excises on jewelry and furs, "document" taxes on securities, and even an excise on playing cards. This was done to help stimulate the economy and because it was felt that such taxes were inherently discriminatory and inappropriate as part of a broad-based tax system. Some excises lingered on to dress up the budget and, in the case of alcohol and cigarette taxes, because they were easy targets. We also added a couple of new ones during the energy crunch of the late 1970's—the gas-guzzler tax and the "windfall" profits tax on oil and gas. Currently, of the *nondedicated* excises—that is, those not deposited in trust funds for specific purposes—only the alcohol, tobacco, windfall profits, and telephone usage taxes provide significant Federal revenue. All the rest of the nondedicated collections amounted to only $400 million in fiscal 1985 and no single excise was over $150 million. (Tax policy trivia question: What

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time-honored weapons still yield $8 million in Federal excise revenues? See answer below at *.)

The following table indicates the change in Federal dependence on excise taxes since many selective excises were repealed in 1965.

**Excise Taxes in the Federal Budget**
**Fiscal 1965 and 1985**
**($ mils.)**

| | 1965 | 1985 |
|---|---|---|
| **Budget or Federal Funds** | | |
| Alcohol | 3,773 | 5,562 |
| Tobacco | 2,149 | 4,779 |
| Manufacturers' excises | 2,870 | 100 |
| Retailers' excises | 513 | — |
| "Windfall" profits on oil & gas | — | 6,396 |
| Miscellaneous | 1,718 | 2,320 |
| Total | 10,911[1] | 19,097 |
| % of total receipts | 9.1% | 2.6% |
| **Trust Funds** | | |
| Highway fund | 3,659 | 13,015 |
| Airport and airway fund | — | 2,851 |
| Other | — | 1,028 |
| Total | 3,659 | 16,894 |
| % of total receipts | 3.1% | 2.3% |
| **Total Excises** | 14,570 | 35,992 |
| % of Total receipts | 12.2% | 4.9% |

[1] Total is net of refunds which were not distributed by category for fiscal 1965 budget funds.
Sources: Budgets of the U.S. Government, FY 1967 and FY 1987.

Obviously, the importance of excises in the overall budget picture has gone down considerably. In fact, if the so-called "windfall" profits tax on oil and gas—which resulted from the special circumstances of the 1970's price controls—is not included in the 1985 list, Federal funds excises would have accounted for only 1.7 percent of total receipts. In the trust fund or dedicated use category, the highway trust fund is very important for financing the Interstate and other Federal highway programs. This is our principal user tax program—conceptually quite different from the Federal funds excises. Otherwise, the only really significant excises now are, in descending order of their revenue impact: alcohol, tobacco, dedicated airport excises, and telephone service. The superfund for cleaning up the environment may join the category if Congress ever agrees on how to extend it.

***Alcohol and tobacco excises present a particular problem for policy directions. Even before the states take their share, these are stiff levies on individual products. Some would justify the high rates of tax because of social opprobrium attached to their use. But can you frown on product consumption and still depend on it as a reliable revenue source?*** Together the alcohol and tobacco taxes brought in $10.3 billion in fiscal 1985, 54 percent of nondedicated excise tax receipts and 29 percent of total excises. Even in today's megabuck budget, this is not an insignificant amount. If, for purposes of tax reform or deficit reduction, Federal excises were made nondeductible for business and either indexing applied to, or effective rates raised for, alcohol, tobacco, and motor fuels, it would accentuate this policy dilemma.

Besides the distillers, brewers, vintners, and tobacco companies, other selected industries, such as trucking, airlines, and petroleum, could be hard hit by the Finance Committee draft proposal. In some cases, the added cost probably would be passed on to consumers. But this would depend on market conditions. Business, i.e., shareholders and employees, undoubtedly would have to bear a good portion of the added burden. This is why the Joint Committee on Taxation is unable to distribute the incidence of the proposed excise boost between individuals and business taxpayers. Furthermore, new taxes on motor fuels, whether for reform or deficit reduction, could reopen the old argument about diversion of dedicated funds—what should go in the trust fund to support the highway program, what goes to the general fund, and why the difference?

In any event, the impact of increased excise taxation, either through increased tax rates or nondeductibility of taxes paid, would be uneven and arbitrary across the economy. And that is the basic reason why tax policy has looked askance at selected excises. ***There really is no policy justification for not allowing a legitimate trade or business to deduct what are clearly business expenses, and possibly substantial ones. The fact that individuals cannot take Federal excise taxes as itemized personal income tax deductions is irrelevant. By the logic of the draft proposal in the Finance Committee, employers' payroll taxes would not be deductible either, as individual employees cannot deduct their social security contributions. No, we are not suggesting a new revenue enhancer, just pointing out the policy confusion.***

Congress may well decide to accept a little more confusion if it will provide a money plug for reform or deficit reduction. It wouldn't be the first time. Admittedly, the other choices are not all that attractive, but it is still very difficult to make a silk policy while biting the ears of selected excises.

## Federal Tax Amnesty—Gimmick or Godsend?

If the Feds could pick up a quick $10 billion or more at minimal administrative cost and without raising anyone's taxes, who wouldn't jump at the chance? Well, the IRS Commissioner for one, who is still dead set against Federal tax amnesty. But others in Congress seem to be cozying up to the idea. It's likely to find a home within the Budget Committees' recommendations for deficit reduction.

As noted in our working paper of September 10, 1985, "Why Not Tax Amnesty?," a number of states have conducted successful tax amnesty programs, some of them far more successful in terms of initial revenue collections than had been anticipated. While details of the programs have differed, the typical pattern has been to offer tax delinquents and nonfilers a "one-time" chance to pay up without penalties or criminal prosecution. Payment of all back taxes and usually interest thereon has been required and those with civil or criminal cases for state tax violations pending have been excluded from amnesty.

The following table from our September paper, updated to include the recent New York State amnesty, shows the initial results of five programs in industrial states, all with significant income tax structures.

In conjunction with their amnesties all five states stepped up enforcement programs such as intensified auditing, stiffer reporting requirements, and larger penalties for noncompliance. These were publicized widely, concurrent with

* bows and arrows

the amnesty period, as the "carrot and stick" approach. Massachusetts, for example, conducted a high visibility campaign about both its amnesty and new enforcement measures. The state attributed a large revenue pickup in fiscal 1984—beyond the direct results of amnesty for back taxes and beyond what could be expected from economic growth—to this campaign. The administrative cost of the amnesty program itself was said to run somewhat over $1 million.

**Selected State Tax Amnesty Receipts**

| State | Period | Total Receipts ($ mils) | Income Tax Related Receipts ($ mils) | Income Tax Related Receipts as % of Total Income Tax Revenues[1] |
|---|---|---|---|---|
| California | Dec 1984-Feb 1985 | 144 | 103 | 0.8% |
| Illinois | Oct-Nov 1984 | 154 | 121 | 3.4% |
| Massachusetts | Aug-Oct 1984 | 85 | 52 | 1.5% |
| Minnesota | Aug-Oct 1984 | 12 | 9 | 0.3% |
| New York | Nov 1985-Jan 1986 | 360 | 209 | 1.8% |

[1]Fiscal 1984, except fiscal 1985 for New York.
Sources: State Taxpayer Research Organizations and Tax Foundation, Incorporated, *Facts and Figures on Government Finance—1986*.

Suppose we did run a national tax amnesty along the lines proposed by Rep. Brian Donnelly (D-MA). His bill, H.R. 2530, would provide a one-time, three-month amnesty based on the Massachusetts experience, coupled with more IRS enforcement powers and hiring of an additional 7,500 enforcement personnel. Disregarding administrative cost and the possible application of such a program to social security, estate and gift, and Federal excise taxes, what would be the potential revenue consequence for income taxes—based solely on the states' experience? The unweighted average of the five state programs listed above was 1.6 percent of their existing revenues. If applied to fiscal 1985 Federal income tax receipts, personal and corporate, that would yield about $6 billion, only a fairly small portion of which could be considered a permanent addition to the revenue base.

Much higher—and lower—numbers have been bandied around. The Senate Budget Committee estimated a range of $7-$25 billion over three years. The Joint Committee on Taxation isn't sure Federal amnesty would raise any net revenue at all. Nobody has a real handle on it. Commissioner Egger of the IRS claims that, over the long term, amnesty could be a net revenue loser, because heretofore honest taxpayers would resent it and let their own compliance slip. He also claims that the Federal collection process is much more sophisticated than any of the states and that many taxpayers who took advantage of state amnesty programs have been paying their proper Federal income taxes right along. All of the states conducting amnesties have agreed to provide the IRS with information on their tax delinquents. It's not known how widely publicized this was, but it does lend some credence to the Commissioner's point.

Recently, the revenue director of one of the above-mentioned states told this writer that amnesty, especially any amnesty with interest forgiveness, was simply discounting the state's receivables. He inferred that his state's "successful" amnesty was mainly a publicity stunt, that the state would have collected the money anyway without giving the wrong signals to the rest of the taxpayer population. This reflects the professional tax collector's disdain for programs that, by their existence, are indictments of the system's ability to function as designed. ***Not too long ago, of course, the IRS itself was extremely reluctant to admit that there was any significant tax evasion problem and to attach any numbers to it. Now, it is readily conceded that we have uncollected taxes in the legal economic sector on the order of $100 billion—a lot of it probably beyond the reach of regular compliance measures no matter how sophisticated. This does not mean that the IRS isn't trying. It just has been overwhelmed by some of the institutional changes in the economy and society.***

Again, in Massachusetts, it was reported that approximately one-third of the 47,000 amnesty participants were nonfilers, some never having filed a state income tax return. While this doesn't say much for the previous state of tax administration in Massachusetts, it does point to some potential long-term gains if those previous nonfilers can be kept on the rolls. Even if a much smaller proportion of nonfilers or nonparticipants were drawn into the Federal system as a result of amnesty, it could have positive effects well beyond the fiscal year in question.

***If a national amnesty is to be seriously considered, its use as a revenue plug for fiscal 1987 should be downgraded. More logically, it should be looked at in conjunction with tax reform stressing simplicity and fairness, at least in the individual sector. The "carrot and stick" would seem to work best with a fresh start on the system. There is no guarantee, of course, that the current reform campaign will fulfill that condition.***

* * * * * * *

# The Chairman's Mark—Other Features

While the excise tax proposals have grabbed the headlines, tax observers have been digging frantically into the 221-page spread sheet containing Chairman Packwood's detailed recommendations to the Finance Committee. They are finding: (a) most of the President's priorities, (b) a lot of the House bill, and (c) some interesting variations. Overall, the Chairman has put together an acrobatic repertory, loosely stitching together all sorts of competing pressures. Whether it would really prove revenue neutral remains to be seen.

As markup already has started, and numerous changes can be expected before this piece appears in print, we shall go light on analysis, touching only on some highlights.

For individuals, the proposed rate structure is more to the President's liking with a top rate of 35 percent, cutting in at a

significantly higher level of taxable income than under the House bill. Upper-income individuals are not necessarily cheering, however, because:

(a) their personal exemption would be phased out over $100,000 in adjusted gross income;

(b) most itemized deductions would be limited to the first two brackets of 15 and 25 percent;

(c) a severe limit on consumer interest deductions; and

(d) in a major break from past proposals, all tax-exempt interest would be considered a preference item under the alternative minimum tax. On announcement, the last-mentioned little wrinkle just about shut down the municipal bond market. It's likely to be dropped or revised substantially.

The most significant itemized deduction affected by (b) immediately above would be for state income taxes, which would seem to be a poor vehicle for income redistribution. But the companion proposal to eliminate deductibility of state sales and personal property taxes entirely is likely to cause an even bigger ruckus.

It was expected that the Chairman would go lighter on employee benefits and retirement income provisions than the House. In some respects, his provisions here are more liberal, but many were taken wholesale from the House bill, and there are stiffer proposed requirements for qualified pension plan coverage, vesting, etc., in line with Senator Heinz's legislation.

Overall, the individual tax changes would reduce income tax liabilities by about the same amount as the House bill, with slightly more going to the low end and slightly less to the high end of the income classification. Upper-income groups would face considerable new complexities in tax compliance.

Business, of course, still shoulders the brunt of increased tax burdens under the Packwood plan. Depending on how you split the excise tax provisions, it bears a little more, or a little less, than under the House bill. No one really expected a major change here.

Capital-intensive industries should be happier with Chairman Packwood's more liberal capital recovery proposal and the investment credit refund. The whole corporate sector would benefit from a 35 percent top rate compared to 36 percent under the House bill. And the foreign income provisions look a little better from the business community view, too.

Cutting the other way, in addition to the excise proposals, are stiffer treatment of banks and insurance companies, dropping entirely the dividend paid deduction, and, quite likely, a much more severe corporate alternative minimum tax. Even with a lower rate than the House bill—20 percent as against 25 percent—the addition of tax-exempt interest and 50 percent of book income over the minimum tax base as preference items could subject many companies to quite substantial minimum tax liability. This also could hit companies in mining, timber, and oil and gas, provisions for which were attacked directly by the House but not by Chairman Packwood's program.

All in all, a mixed bag, which faces severe tests in Committee and on the Senate floor. Stay tuned.

* * * * * * *

# Business Tax Burdens—III
# The Vanishing Tax Cut From 1981

No question that part of the business bashing in the current reform campaign is in reaction to repeated charges that the corporate income tax virtually was eliminated by the Economic Recovery Tax Act of 1981 (ERTA). This was a vast overstatement, even right after ERTA, and seems pretty silly in relation to what has happened since and what has been proposed in the way of reform. Yet, we keep hearing reference to the great corporate giveaway of 1981 as a rationale for increasing business tax burdens.

Just to help set the record, we reproduce figures from the fiscal 1987 budget document, which are quite instructive in this regard.

Lest anyone accuse the Administration of fudging them, the Joint Committee on Taxation has indicated the same type of results.

**Effect of Major Enacted Legislation From 1981 Through 1985 on Corporate Income Tax Receipts, 1985-1989**
**($ bils.)**

| | 1985 | 1986 | 1987 | 1988 | 1989 |
|---|---|---|---|---|---|
| Economic Recovery Tax Act of 1981 | -32.0 | -43.4 | -51.6 | -54.9 | -56.2 |
| Tax Equity and Fiscal Responsibility Act of 1982 | 19.2 | 30.3 | 39.7 | 42.8 | 42.6 |
| Highway Revenue Act of 1982 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 |
| Deficit Reduction Act of 1984 | 3.3 | 5.8 | 8.1 | 9.7 | 10.6 |
| **Net Effect[1]** | **-12.1** | **-10.5** | **- 7.4** | **- 5.2** | **- 4.2** |
| Addendum | | | | | |
| Net Effect of Period Legislation on Individual Income Taxes | -114.9 | -133.5 | -156.1 | -178.1 | -202.9 |

[1] Individual acts do not sum exactly to net effect because of interaction effects.
Source: Budget of the U.S. Government, FY 1987.

## *Businessman Launched Tax Freedom Day in '48*

Tax Freedom Day is thirty-eight years old this year. Dallas L. Hostetler, Executive Director of the Florida State Retailers Association, originated the notion of a Tax Freedom Holiday in 1948. His idea marks the first day of the year in which American taxpayers started working for themselves, instead of for the funding of Federal, state, and local government.

Hostetler's efforts soon gained widespread attention. In 1950, a Concurrent Resolution of the U.S. House of Representatives and Senate concluded by resolving the "Tax Freedom Holiday be symbolized as a day of relief throughout the land, with such demonstrations as may seem appropriate, including prayer for deliverance." In 1953, Hostetler received the Freedoms Foundation's George Washington Honor Medal Award.

In 1974 Hostetler contacted the Tax Foundation and asked the non-profit tax watchdog organization to carry on his effort to highlight the true size of the tax burden. "At age 72," he wrote, "I must forego the annual promotion of this observance. In the interest of perpetuating the idea, I would like to turn it over, without obligation, to some nationally known and highly respected tax organization. Obviously, I thought first of your Tax Foundation, Inc."

Tax Foundation had already highlighted Tax Freedom Day in its own materials and had been computing, since 1953, the size of the tax bite from the average person's eight-hour workday (see accompanying article). Foundation analysts were delighted to accept Hostetler's offer of the concept, which he had registered with the U.S. Copyright Office in 1953. It has proven to be one of the most widely reported pieces of research issued by the Tax Foundation each year.

(**TAX FREEDOM DAY,** *from page 1)*

payer has coincided with May Day, an interesting convergence in view of the international acceptance of that term as a distress call.

The table on page 1 documents the date for Tax Freedom Day for selected years.

# THE FRONT BURNER

**By Robert C. Brown, President Tax Foundation, Incorporated**

## *"Amnesty for Tax Cheats?"*

Nothing is so powerful as an idea whose time has come—especially when it purports to bring in between $8 and $20 billion to Federal coffers. The idea is tax amnesty, already implemented with surprising success by some 18 states, to the tune of about $800 million.

However, what's sauce for the states is not necessarily sauce for the Federal gander. There are problems with tax amnesty:

**Fairness.** Does amnesty for tax cheats makes patsys of those who have paid their fair share—plus the scofflaws' share—all along?

**Reinforcement of negative behavior.** Having been forgiven once, will tax cheats expect to be forgiven again—perhaps every five years or so?

**Optimistic revenue projections.** Federal tax collections have always been much more stringent than states' policing of their revenue systems. How much collectible revenue is actually escaping the IRS?

Estimates are squishy. The Senate Budget Committee staff forecasts $11.7 billion over three years. The Senate Finance Committee Chairman foresees a windfall between $12 and $20 billion over three years. The IRS and the Joint Committee on Taxation refuse to forecast.

A case is also made that, once tax cheats are introduced back into the tax collection mainstream, most will stay there.

What to do?

For openers, let's have a full and free discussion. When a proposal with such far-reaching consequences surfaces, we must make certain the legislative process remains fully deliberative.

Second, if we do do it, Uncle Sam must promote the concept with all the fervor used to sell bonds during World War II. Amnesty won't just happen. It must be made to happen.

Next, make certain—and obvious—that enforcement will be beefed up.

Finally, any tax delinquents who do return to the fold should be kept on a separate tracking system—permanently. In essence, they are on parole.

Any scheme that promises to increase Federal revenues and bring tax dodgers back to the fold ought to be looked at. Before it becomes policy, it ought to be given a second—very close—look by all parties involved.

**Tax Foundation, Incorporated**

(FEDERAL TAX BURDEN, *from page 2)*

bear 3 percent of the Federal tax burden ($21.4 billion) in fiscal year 1986:

| | |
|---|---|
| ME | $2.9 billion |
| DC | $2.7 billion |
| AK | $2.5 billion |
| ID | $2.3 billion |
| MT | $2.2 billion |
| DE | $2.1 billion |
| ND | $2.0 billion |
| SD | $1.7 billion |
| WY | $1.6 billion |
| VT | $1.4 billion |

### Per Capita Burdens

Per capita tax burdens, by contrast, tend to hit hardest in states with relatively high average income levels. In fiscal year 1986, residents in the ten states with the highest per capita tax burdens will pay approximately 38.0 percent of the tax bill, about $286.3 billion. Their average Federal tax burden will be $3,684, about 18 percent higher than the national average of $3,133. Citizens in the ten states with the lowest per capita tax burdens will pay $54.1 billion, or 7.2 percent of the total. Their average tax burden works out to $2,421 per person, about 23 percent below the national average.

| "Top Per Capita" | | "Bottom Per Capita" | |
|---|---|---|---|
| AK | $4,907 | NM | $2,477 |
| DC | $4,582 | ME | $2,471 |
| CT | $4,478 | KY | $2,347 |
| NJ | $4,203 | AL | $2,344 |
| MA | $3,761 | SC | $2,317 |
| MD | $3,667 | WV | $2,236 |
| NY | $3,635 | AR | $2,230 |
| IL | $3,541 | UT | $2,193 |
| CA | $3,485 | ID | $2,162 |
| DE | $3,416 | MS | $1,978 |

**Tax Bite in the Eight-Hour Day and Tax Freedom Day 1980-1986[a]**

| Item | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986[c] |
|---|---|---|---|---|---|---|---|
| Taxes | 2:39 | 2:43 | 2:41 | 2:38 | 2:36 | 2:39 | 2:39 |
| Federal | 1:48 | 1:52 | 1:48 | 1:43 | 1:42 | 1:44 | 1:44 |
| State and local | :51 | :51 | :53 | :54 | :54 | :55 | :55 |
| Food and tobacco | 1:03 | 1:01 | 1:04 | 1:03 | 1:04 | 1:00 | 1:00 |
| Housing and household operation | 1:24 | 1:23 | 1:30 | 1:29 | 1:31 | 1:27 | 1:26 |
| Clothing | :19 | :18 | :19 | :19 | :19 | :19 | :18 |
| Transportation | :41 | :40 | :40 | :41 | :43 | :41 | :41 |
| Medical care | :32 | :33 | :37 | :38 | :39 | :38 | :37 |
| Recreation | :20 | :19 | :21 | :21 | :22 | :21 | :21 |
| All other[b] | 1:02 | 1:03 | :48 | :51 | :46 | :55 | :58 |
| **Tax Freedom Day:** | **May 1** | **May 4** | **May 3** | **April 30** | **April 28** | **May 1** | **May 1** |

[a]Data reflect recent benchmark revisions in national income and product accounts.
[b]Includes personal care, personal business, private education and research, religious and welfare activities, net foreign travel, and net savings.
[c]Forecast.
Source: Tax Foundation, derived from data supplied by U.S. Department of Commerce, Bureau of Economic Analysis.

### Tax Foundation's Formula

Tax Foundation's formula is designed to show where Federal tax burdens actually fall, rather than where taxes are collected. By contrast, U.S. Treasury figures show where taxes are collected, but do not purport to provide a picture of the state-by-state impact of Federal taxation.

An example of how the two methodologies differ appears in comparison of data related to the collection of Federal excise taxes on tobacco products. Treasury data show these taxes as collected mainly in a few southern states. However, the burden of these taxes may be assumed to fall on consumers of these products in all states, so that collections data do not show who is actually bearing the burden of these taxes.

The table on page 2 provides further details.

(TAX BITE, *from page 1)*

and welfare activities, net foreign travel, and net savings. These items will require 3 more minutes' work this year than they did last.

The total tax burden per 8-hour day for 1986 is exactly the same as it was in 1980. The landmark tax cuts of the 1981 Economic Recovery Tax Act of 1981 (ERTA) caused a drop in the Federal portion of the tax burden, lessening the work time required to cover taxes in 1982, 1983, and 1984. Last year, the cycle had come full course, as subsequent increases in Federal business and payroll taxes eroded some of the gains under ERTA, and as the total tax take increased apace of the economic rebound.

The accompanying table gives full details for taxes and other major cost areas, broken down as a portion of the typical 8-hour workday from 1980 to the present.

TAX FOUNDATION, INCORPORATED
One Thomas Circle, N.W., Suite 500, Washington, D.C. 20005

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